

1 CHARLES D. AXELROD (SBN 39507)  
2 GARY E. KLAUSNER (SBN 69077)  
3 H. ALEXANDER FISCH (SBN 223211)  
4 MARINA FINEMAN (SBN 193065)  
5 STUTMAN, TREISTER & GLATT  
6 PROFESSIONAL CORPORATION  
7 1901 Avenue of the Stars  
8 12th Floor  
9 Los Angeles, CA 90067  
10 Telephone: (310) 228-5600  
11 Telecopy: (310) 228-5788  
12 Email: gklausner@stutman.com;  
13 afisch@stutman.com

14 DANIEL K. SPRADLIN (SBN 82950)  
15 M. LOIS BOBAK (SBN 127540)  
16 WOODRUFF, SPRADLIN & SMART, APC  
17 555 Anton Boulevard, Suite 1200  
18 Costa Mesa, California 92626-7670  
19 Telephone: (714) 558-7000  
20 Facsimile: (714) 835-7787  
21 Email: dspradlin@wss-law.com;  
22 lbobak@wss-law.com

23 Attorneys for Appellee  
24 Valley Health System

25 R.D. KIRWAN (SBN 46259)  
26 CHAD STEGEMAN (SBN 225745)  
27 DEVIN STONE (SBN 260326)  
28 AKIN GUMP STRAUSS HAUER & FELD LLP  
2029 Century Park East, Suite 2400  
Los Angeles, California 90067  
Telephone: (310) 229-1000  
Facsimile: (310) 229-1001  
Email: rkirwan@akingump.com;  
cstegeman@akingump.com;  
dstone@akingump.com

Attorneys for Appellee  
Physicians for Healthy Hospitals, Inc.

**UNITED STATES DISTRICT COURT  
CENTRAL DISTRICT OF CALIFORNIA  
WESTERN DIVISION**

In re

VALLEY HEALTH SYSTEM, a  
California Local Health Care District,

Debtor.

PRIME HEALTHCARE  
MANAGEMENT, INC., a California  
Corporation; ALBERT L. LEWIS, JR.,  
a taxpayer and resident of the VHS local  
health care district; JOHN LLOYD, a  
taxpayer and resident of the VHS local  
healthcare district; EDWARD J.  
FAZEKAS, a taxpayer and resident of  
the VHS local health care district,

Appellant,

v.

VALLEY HEALTH SYSTEM, a  
California local healthcare district;  
PHYSICIANS FOR HEALTHY  
HOSPITALS, INC., a California  
Corporation,

Appellees.

D.C. Case No.: 10-CV-00730-SVW

Bankr. Case No. 6:07-bk-18293-PC

Adv. Pro. No. 6:09-ap-01708-PC

Chapter 9

**DECLARATION OF GARY E.  
KLAUSNER IN SUPPORT OF  
APPELLEES' JOINT MOTION TO  
DISMISS APPEAL AS MOOT**

Hearing

Date: November 22, 2010

Time: 1:30 p.m.

Judge: Hon. Stephen V. Wilson

Place: Courtroom 6  
312 N. Spring Street  
Los Angeles, CA 90012

I, Gary E. Klausner, hereby declare that,

1. I am an attorney duly licensed and admitted to practice before all  
state courts within the State of California and before the United States District Court  
for the Central District of California, as well as the Ninth Circuit Court of Appeals and  
the United States Supreme Court. I am a shareholder of the law firm of Stutman,

1 Treister & Glatt Professional Corporation ("ST&G"), which is bankruptcy counsel to  
2 Valley Health System, a California Local Healthcare District (the "District").

3 2. Unless otherwise indicated, the facts stated herein are based upon  
4 my personal knowledge of the matters contained herein, and, if called upon to testify,  
5 I could and would testify to each such matter based upon personal knowledge thereof.  
6 I submit this declaration in support of the "Appellees' Joint Motion to Dismiss Appeal  
7 As Moot" (the "Motion to Dismiss").<sup>1</sup>

8 3. I have been the ST&G attorney with primary responsibility for  
9 representing the District in its Chapter 9 Case for more than two years, and am  
10 familiar with all major events that have occurred in the case because of my personal  
11 involvement in the case. I was closely and directly involved in the negotiation and  
12 drafting of both the ASA and the Plan. Thus, I am familiar with the terms of both  
13 documents. True and correct copies of the ASA and the Plan are included in the  
14 "Appendix to Appellees' Joint Motion to Dismiss" (the "Appendix") as Exhibits "3"  
15 and "4," respectively. I was also involved in the negotiations that led to the  
16 modification of the Plan filed on February 19, 2010, and am familiar with the  
17 modifications, which are a part of the Plan. A true and correct copy of the pleading  
18 setting forth the Plan modifications is included in the Appendix as Exhibit "5."  
19 Additionally, I have been closely involved in the Sale of the District's assets and other  
20 actions taken by the District in reliance of the Confirmation Order.

21 4. The District filed a petition for relief under chapter 9 of the  
22 Bankruptcy Code on December 13, 2007. The Bankruptcy Court entered an order for  
23 relief thereon on February 20, 2008. After approximately a year and a half in the  
24 Chapter 9 Case, and unable to develop an internal, "stand alone" restructuring plan,  
25

26 <sup>1</sup> All capitalized terms not defined herein shall have the meaning set forth in the  
27 Motion to Dismiss.  
28

1 the District entered into a term sheet and eventually the ASA with PHH, pursuant to  
2 which the District would sell, and PHH would purchase, substantially all of the  
3 District's assets.

4           5. The Board approved the ASA on October 6, 2009. Thereafter,  
5 Prime commenced the Challenge Actions, seeking to block the public vote on  
6 Measure P and the consummation of the Sale.

7           6. The District filed its plan of adjustment, which was originally  
8 premised on the Sale or an alternative transaction where less than 50% of the District's  
9 assets would be sold, along with a related disclosure statement, on November 2,  
10 2009.<sup>2</sup> To expedite resolution of the Challenge Actions, the District and Appellants  
11 stipulated that all of the Challenge Actions would be tried in the Bankruptcy Court as  
12 part of the plan confirmation process and that the Bankruptcy Court would have  
13 jurisdiction to adjudicate all of the issues pertaining to these actions. The Bankruptcy  
14 Court entered an order on December 23, 2009 which provided for the Bankruptcy  
15 Court to hear and decide the Challenge Actions as part of the Plan confirmation  
16 process and scheduled the Plan confirmation hearing and the evidentiary hearings  
17 regarding the Challenge Actions to begin on February 9, 2010 and to continue  
18 thereafter on February 22, 2010.<sup>3</sup>

19  
20 <sup>2</sup> After the District's citizens approved Measure P, and thus the Sale, in a public  
21 election, the District amended the Plan and disclosure statement on December 17,  
22 2009 to eliminate reference to the alternative transaction, so that the Plan was  
premiered solely on the Sale. The District also modified the Plan on February 19,  
2010 to enhance the treatment of creditors.

23 <sup>3</sup> See Order approving the disclosure statement, dated December 23, 2009, which  
24 appears as Docket No. 694 in case number 07-18293, a true and correct copy of  
25 which is included in the Appendix as Exhibit "7." The parties memorialized their  
26 agreement regarding the Bankruptcy Court's resolution of the Challenge Actions in  
27 a subsequent stipulation, which was approved by the Bankruptcy Court's "Order  
Dismiss Appeal and to Adjudicate Issues Raised by Challenge Actions", entered on  
January 22, 2010, which appears as Docket No. 755 in case number 07-18293, a

1           7. Prime also opposed confirmation of the District's Plan on grounds  
2 other than the Challenge Actions. On January 25, 2010 – the deadline to file  
3 objections to confirmation of the Plan – Prime purchased a \$4,920 general unsecured  
4 claim in the Chapter 9 Case and thereby acquired standing to object to confirmation of  
5 the Plan.<sup>4</sup> On the same day, Prime filed an objection to the Plan.

6           8. The District's Plan was accepted by over ninety-seven percent  
7 (97%) of its creditors who voted. The hearing on confirmation of the Plan  
8 commenced on February 9, 2010, by which time all objections to the Plan, except for  
9 Prime's, had been withdrawn. Prime's Plan objections were based on its contentions  
10 that: (1) PHH did not have the financial resources to fund the closing of the Sale, and  
11 thus the Plan was not "feasible," and (2) the various claims set forth in the Challenge  
12 Actions made the ASA unenforceable.

13           9. The hearing on feasibility took place on February 22, 2010. On  
14 February 23, 2010, the Bankruptcy Court ruled that the District had provided  
15 sufficient evidence of feasibility and overruled Prime's objection on that ground. A  
16 true and correct copy of the relevant pages of the transcript reflecting where the  
17 Bankruptcy Court overruled Prime's feasibility objection is included in the Appendix  
18 as Exhibit "9."

19           10. The Challenge Actions were tried for four full court days, from  
20 February 23 through 26. During that trial, the parties presented ten witnesses,  
21 introduced more than one hundred pieces of evidence, and presented extensive oral  
22 argument at the conclusion of the trial. The Bankruptcy Court then took the matter  
23 under submission.

24  
25 true and correct copy of which is included in the Appendix as Exhibit "8." None of  
these orders were appealed.

26 <sup>4</sup> The prior holder of the \$4,920 claim, BP Cabinets, had voted in favor of Plan  
27 confirmation.  
28

1           11. The Bankruptcy Court entered the Confirmation Order on April 26,  
2 2010, having issued its Memorandum of Decision on April 8, 2010. True and correct  
3 copies of the Confirmation Order and the Bankruptcy Court's Memorandum of  
4 Decision are included in the Appendix as Exhibits 1 and 2, respectively.

5           12. The Appellants never sought a stay of the Confirmation Order, and  
6 nothing precluded the District or any other party from taking the actions expressly  
7 authorized by the Confirmation order, including closing the Sale. The Sale closed on  
8 October 13, 2010, and the District immediately began to implement the Plan, as many  
9 of the payment obligations under the Plan came due upon that same date. The  
10 "Effective Date" of the Plan occurred on October 13, 2010.

11           13. The Plan has now been substantially consummated. The only  
12 significant tasks that remain under the Plan are the completion of the claims review  
13 process, the distributions to be made by the Class 2A Claims Allowance/Disbursing  
14 Agent over the next four years, and distributions to certain administrative claimants.

15           14. The closing of the Sale and effectiveness of the Plan have resulted  
16 in significant changes to the rights of many parties that are not directly involved in  
17 this Appeal.

18           15. Among other things, as of the Effective Date, the District has  
19 "assumed and assigned" to PHH approximately four hundred executory contracts and  
20 unexpired leases with various entities, including without limitation, insurance agents,  
21 medical groups, pharmacies and other medical service providers, software and  
22 equipment lessors and licensors, and insurance companies. PHH is now liable to  
23 counterparties who are not parties to the Appeal for all current and future amounts due  
24 and owing under such contracts, including any damages that may result from the  
25 breach or early termination thereof, and the contract parties have no recourse against  
26 the District. *See* App. Ex. 4 (Plan § VI.A).

27           16. Select VHS Acquisition Company, LLC ("Select") no longer has  
28

1 recourse against the District under a \$9 million postpetition note that was assumed by  
2 PHH under the Plan. *See* App. Ex. 4 (Plan § III.A.1).

3 17. Also as of the Effective Date, creditors asserting "current"  
4 administrative claims against the District, which were assumed by PHH under the  
5 Plan, no longer have recourse against the District. *See* App. Ex. 4 (Plan §§ III.A.2,  
6 VII.A(3)).

7 18. PHH has assumed approximately \$55 million in general unsecured  
8 claims owed by the District to holders of claims classified in the Plan as Class 2B  
9 claims, which result from the District's rejection and/or breach of such parties'  
10 contracts. Under the terms of the Plan, none of these creditors has any further  
11 recourse against the District. *See* App. Ex. 4 (Plan §§ IV.D, VII.A(6)).

12 19. The District has also assumed: (i) approximately forty payor  
13 contracts (such as with Blue Cross, Blue Shield, etc.) which it will assign to PHH  
14 once PHH obtains its Licenses; and (ii) approximately forty physician and government  
15 contracts (such as with Medi-Cal and Medicare), which the District will terminate  
16 once PHH has obtained all necessary licenses and Medicare Certifications and is able  
17 to enter into new agreements with these persons and entities. As a result of the Plan,  
18 the ASA, and the Management Agreement between the District and PHH described in  
19 the Declaration of John B. Marshall, PHH is now liable, in 100 cent dollars, for all  
20 current and future amounts due and owing under such contracts, including any  
21 damages that may result from the early termination thereof.

22 20. The District has rejected and/or terminated approximately thirty  
23 prepetition and postpetition agreements with, among others, laboratories, technical  
24 service providers, medical service providers, and surgical centers, which would be  
25 required for the District to operate the Hospitals.

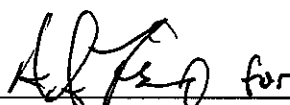
26 21. The District has distributed the bulk of the proceeds that it received  
27 from PHH to the District's creditors. The Plan required the District to distribute, to the  
28

1 indenture trustee for the Bondholders, an amount sufficient to fully satisfy all of the  
2 Bondholder's claims, including payment of all outstanding principal and accrued  
3 interest through the closing date of the Sale, plus all related outstanding fees and  
4 expenses, of the indenture trustee and its attorneys and advisors, to which the  
5 indenture trustee is entitled. *See* App. Ex. 4 (Plan § IV.A & B). I am informed and  
6 believe that on the closing date of the Sale, the District distributed \$48,509,830.46 to  
7 the Bondholders' indenture trustee. The Plan also required the District to distribute \$2  
8 million on the Effective Date to general unsecured creditors, who are classified in  
9 Class 2A of the Plan. *See* App. Ex. 4 (Plan § IV.D.2); Ex. 5 (Plan Modifications  
10 ¶ 2(i)). The District distributed \$2 million on the Effective Date to the Claims  
11 Allowance/Disbursing Agent, as defined in the Plan, who is responsible for making  
12 distributions to holders of Class 2A claims.

13           22. Based on these changes of position in reliance of the unstayed  
14 Confirmation Order, it would be impossible to reverse the transactions that have been  
15 completed in reliance on the Confirmation Order and "undo" the Plan and ASA.

16           I declare under penalty of perjury that the foregoing is true and correct.

17           Executed this 22nd day of October 2010 at Los Angeles, California.

18  
19   
20 \_\_\_\_\_  
Gary E. Klausner